

Akerman Business Update

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Public-Private Investment Program - Legacy Loans

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A significant component of the current economic crisis is the problem of distressed real estate loans held by financial institutions. As the economy deteriorated, many real estate loans both commercial and residential have defaulted and become distressed assets on the books of the institutions that made them.

To help remove these distressed assets from financial institutions the Administration has announced the Public-Private Investment Program (PPIP). The program is under development. The following is a general outline of what is currently known about the program as it relates to non-performing loans (Legacy Loans). Those interested should monitor developments closely.

Legacy Loans Program Overview

Creation of Loan Pools. A financial institution wishing to participate in the program to sell loans works with its primary regulator to construct a pool of loans to be sold.

Diligence/Marketing. Once the pool has been constructed by the FDIC and the financial institution, the FDIC will market the pool and make diligence materials available to potential investors.

Investors. Only pre-approved investors will be permitted to participate as bidders in the loan-pool auctions. The FDIC has not yet released bidder qualifications.

Bidding. The public announcement of the program stated that in the auction potential investors will not bid on the loan pool itself. Rather, they will bid on a 50%

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equity stake in a partnership that the FDIC will set up to acquire the loan pool from the selling financial institution. Bidders will be required to make a cash deposit equal to 5% of their bid. There have been reports that the concept of a government stake is being rethought in the light of issues regarding executive compensation.

Treasury Stake in Partnership Equity. Treasury will own a 50% non-voting stake in the partnership's equity.

Partnership Debt. To finance a portion of the loan pool purchase price, the partnership will issue non-recourse FDIC-guaranteed debt in accordance with a leverage ratio determined by the FDIC in advance of the auction. The leverage ratio will vary from pool to pool depending upon the risk of the underlying loans, but will not exceed a maximum of 6 to 1. The FDIC will include the leverage ratio applicable to a pool in the pre-bid marketing materials so bidders can factor it into their valuations.

Purchase Price Calculation. The total purchase price for a loan pool will be extrapolated from the amount of the winning bid. To illustrate, assume that the winning bid for the private equity of a particular partnership is \$25 million. Treasury would match this contribution by putting up \$25 million for its 50% equity interest in the partnership, bringing the total value of the partnership's equity capital to \$50 million. Assuming a leverage ratio of 6 to 1, the partnership would then issue \$300 million in FDIC-guaranteed debt for a total purchase price of \$350 million.

Partnership Control. The winning bidder will control the partnership, the purchased loans in the pool and the related servicing rights. However, the FDIC has said that it will “establish governance procedures on the management, servicing agreement, financial and operating reporting requirements, exit timing and alternatives” for each pool. Thus, the exact parameters of private investor control have yet to be defined.

Fees. The partnership will be required to pay on-going administration and loan guarantee fees to the FDIC in amounts that have not yet been determined.

Key Unresolved Issues

The Legacy Loans Program is still very much a work in progress. After releasing the initial term sheet in late March, the FDIC conducted an informal public comment period that ended on April 10th and generated over 400 public comments, including our own. The following is a brief summary of some of the key unresolved issues:

Pool Size. Pool size will have a big impact on investor participation. For example, if the minimum pool size is set at \$1 billion, many local investors will be priced out of the program.

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Pool Composition. Pool composition also will impact investor participation. For example, if pools are composed of national portfolios of loans, investors with extensive local knowledge will be less inclined to participate. Similarly, if the collateral underlying the pools is not homogenous, niche investors with expertise in certain areas of the real estate market will be less inclined to participate.

Financial Institution Participation. A key concern among commentators is that financial institutions will be unwilling to impair their capital position by selling loans at a loss. It remains to be seen how this concern will be addressed, but the hope is that the FDIC will flex some regulatory muscle to nudge financial institutions in the right direction. Commentators have also suggested that the FDIC implement rules designed to soften the short-term capital impact of a sale.

Reserve Prices. The initial term sheet for the program gives selling financial institutions total discretion to accept or reject the highest bid at the conclusion of an auction. Investors are understandably troubled by the prospect of devoting time and resources to the bidding process only to have a financial institution reject their winning bid. To address this concern, it appears that the FDIC may be considering some kind of a reserve price mechanism whereby financial institutions will be required to sell if the winning bid is in excess of a certain threshold.

Looking Forward

In conclusion, the Legacy Loans Program is still taking shape. While the FDIC has provided no definitive timeline, we expect to see greater detail regarding the program within the next 4 weeks. If the program is ultimately structured to facilitate broad participation by local investors and financial institutions, it could produce some compelling investment opportunities. Accordingly, investors with real estate expertise and access to capital would be well-advised to keep an eye on the program as it evolves. We will continue to monitor the situation closely and circulate timely updates in connection with any material developments.

J. Thomas Cardwell is chair of the Financial Institutions group. He has served as General Counsel to the Florida Bankers Association for 24 years. He has participated in the development of financial institutions legislation and regulation in Florida for the past several decades. He graduated from Duke University and the University of Florida College of Law.

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If you have any questions about the Legacy Loans Program, please feel free to contact J. Thomas Cardwell, Jed Freeland or any of the Akerman attorneys with whom you normally consult.

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